

Message Text

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ACTION NEA-11

INFO OCT-01 EUR-12 EA-10 ISO-00 CIAE-00 DODE-00 PM-05
H-01 INR-10 L-03 NSAE-00 NSC-05 PA-01 SP-02
SS-15 ICA-11 AID-05 COME-00 EB-08 FRB-03 TRSE-00
XMB-02 OPIC-03 LAB-04 SIL-01 OMB-01 AGRE-00 /114 W
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R 271035Z JUN 78
FM AMEMBASSY ISLAMABAD
TO SECSTATE WASHDC 7853
INFO AMEMBASSY DACCA
AMEMBASSY KABUL
AMEMBASSY LONDON
AMEMBASSY MANILA
AMEMBASSY NEW DELHI
AMEMBASSY PARIS
AMEMBASSY TEHRAN
AMCONSUL KARACHI
AMCONSUL LAHORE

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MANILA FOR ADB; PARIS FOR USOECD

E.O. 11652: N/A
TAGS: EGEN, PK
SUBJECT: ALL HELP TO THE PRIVATE SECTOR

1. SUMMARY: AT A RECENT SPEECH AT THE KARACHI STOCK EXCHANGE
GENERAL ZIA OFFERED THE PRIVATE SECTOR INCENTIVES WHICH HE SAID
WERE BEYOND WHAT THEY ENJOYED "DURING THE GOLDEN ERA OF THE
1960S." ZIA SAID PAKISTAN HAD GONE THROUGH TWO ECONOMIC PERIODS,
ONE CHARACTERIZED BY GROWTH AND UNEQUAL DISTRIBUTION OF WEALTH,
THE OTHER CHARACTERIZED BY STATED INTENTIONS OF EQUALITY BUT WITH
NO RESULTS ON EITHER THE PRODUCTIVITY OR DISTRIBUTION FRONTS. HIS
PACKAGE INCLUDES A CONSTITUTIONAL GUARANTEE AGAINST
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NATIONALIZATION, FURTHER DENATIONALIZATIONS, EXTENSION OF TAX
CREDITS AND CONSIDERATION OF OTHER TAX RELIEF AND LOWER BANK
RATES. ZIA'S INCENTIVES PLACE HIS ADMINISTRATION SQUARELY IN THE
FIRST (I.E., PRE-BHUTTO) PERIOD. IT IS NOT CLEAR HOW HE PLANS TO
SQUARE THIS RETURN TO "TRICKLE-DOWN" ECONOMICS WITH THE CURRENT
EMPHASIS ON BASIC HUMAN NEEDS AND GROWTH WITH EQUITY. HE ALSO
TOOK THE OCCASION TO BLAME SHORTAGES OF ESSENTIAL COMMODITIES ON

UNSCRUPULOUS TRADERS AND ASKED FOR SUGGESTIONS FOR WAYS TO CONTROL PRICES. END SUMMARY.

2. GENERAL ZIA TOOK THE OCCASION OF HIS APPEARANCE AT THE ANNIVERSARY CELEBRATION ON JUNE 20 OF THE FOUNDING OF THE KARACHI STOCK EXCHANGE TO SAY IN CLEAR BUT INELEGANT LANGUAGE THAT THE GOP IS WILLING TO OFFER THE PRIVATE SECTOR INCENTIVES "BEYOND THE EXPECTATIONS OF THE PRIVATE SECTOR AS ENJOYED BY THEM DURING THE GOLDEN ERA OF THE 1960S." ZIA SAID THE GOVERNMENT IS PREPARED TO GIVE "CONSTITUTIONAL GUARANTEES THAT NO PRIVATE PROPERTIES AND ENTERPRISES PERMISSIBLE UNDER ISLAMIC PROVISIONS WOULD BE DISTURBED." WHILE NO GOVERNMENT CAN GIVE AN OPEN-ENDED GUARANTEE AGAINST NATIONALIZATION, THE EXPRESSION OF INTENT MAY ENCOURAGE THE PRIVATE SECTOR. MORE IMPORTANT WOULD HAVE BEEN A SPELLING OUT OF PROVISIONS ABOUT TERMS OF COMPENSATION, E.G., TIME LIMIT FOR FULL COMPENSATION AND BASIS FOR VALUATION OF ASSETS FOR FIRMS WHICH MAY BE NATIONALIZED IN THE FUTURE.

3. PERHAPS MOST SIGNIFICANTLY, ZIA SAID PAKISTAN HAD GONE THROUGH TWO ECONOMIC PERIODS, ONE IN WHICH WEALTH WAS CONCENTRATED IN THE HANDS OF A FEW AND ANOTHER WHICH ATTEMPTED TO DISTRIBUTE PAKISTAN'S WEALTH MORE EQUITABLY. PRODUCTION INCREASED DURING THE FIRST PERIOD BUT NEITHER PRODUCTION NOR THE COMMON MAN BENEFITED DURING THE SECOND. HE DID EXPRESS CONCERN OVER THE GAP BETWEEN THE RICH AND POOR IN PAKISTAN AND SAID THAT THE PRESENT GOVERNMENT WANTS TO SEE A PARTNERSHIP BETWEEN THE PUBLIC AND LIMITED OFFICIAL USE

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PRIVATE SECTOR FOR THE BENEFIT OF ALL.

4. ZIA ALSO MENTIONED THE LIKELIHOOD OF FURTHER DENATIONALIZATIONS, "PARTICULARLY IN THE ENGINEERING SECTOR, DEPENDING ON THEIR PERFORMANCE." THIS IS CONSISTENT WITH A RECENT CONVERSATION THE DCM HAD WITH ABDUL MAJID MUFTI, SECRETARY, MINISTRY OF PRODUCTION, IN WHICH MUFTI SAID THAT A LIGHT ENGINEERING FIRM AROUND NOWSHERA WOULD BE DENATIONALIZED (ALTHOUGH THE DENATIONALIZATION HASN'T YET MATERIALIZED). MUFTI ADDED THAT THE GOVERNMENT WAS CONSIDERING STILL FURTHER DENATIONALIZATION OF LIGHT ENGINEERING COMPANIES.

5. ZIA WENT ON TO SAY THE TAX EXEMPTION FOR CAPITAL GAINS, WHICH WAS DUE TO EXPIRE JUNE 30, WOULD BE EXTENDED AND TO CLARIFY THE EXEMPTION OF DIVIDENDS OF CORPORATIONS LISTED ON THE STOCK EXCHANGE SINCE JULY 1, 1977. THE EXEMPTION WOULD TAKE EFFECT WHEN THE FIRM BEGINS PRODUCTION. IN PRACTICE MANY PAKISTANI OWNERS HAVE USED THIS TAX BREAK TO MILK THEIR FIRMS VIA UNREALISTICALLY HIGH PAY-OUTS. EITHER THE FIRM ULTIMATELY BECOMES A SHELL WHICH MUST GO UNDER OR BORROW HEAVILY FOR WORKING CAPITAL, REPLACEMENT, AND EXPANSION. PERIODS OF ECONOMIC AND POLITICAL UNCERTAINTY SUCH AS PAKISTAN IS PASSING THROUGH HEIGHTENS THE TEMPTATION TO MISUSE

THE DIVIDENT EXEMPTION.

6. ZIA ALSO SAID THAT LOWERING INTEREST RATES ON LOANS WAS UNDER CONSIDERATION, WITHOUT SAYING HOW IT WOULD BE ACCOMPLISHED, ALONG WITH LIFTING THE TEN PERCENT INCOME TAX SURCHARGE ON 1977-78 INCOME.

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7. ZIA EXHORTED THE OWNERS OF DENATIONALIZED AGRO-BASED INDUSTRIES TO LIVE UP TO THEIR PROMISES OF FAIR PRICING AND SUPPLY. ABOUT SUPPLY, ZIA ALSO REFERRED TO SHORTAGES OF CIGARETTES, PETROL, AND OTHER PRODUCTS, CONDEMNING "UNSCRUPULOUS TRADERS WHO HAD NO CONSIDERATION FOR THE PEOPLE, THE COUNTRY AND FOR THAT MATTER THEIR RELIGION WHICH FORBIDS PROFITEERING AND HOARDING." HE REITERATED THE GOVERNMENT'S COMMITMENT TO HOLD DOWN PRICES AND ASKED THE PRIVATE SECTOR TO GIVE HIM ITS SUGGESTIONS FOR MAINTAINING PRICES AT A REASONABLE LEVEL. THERE HAVE BEEN NUMEROUS REPORTS OF SHORTAGES AND AT LEAST THREE HIGH-LEVEL OFFICIALS HAVE LOST THEIR JOBS, AT LEAST PARTIALLY BECAUSE OF THE SCARCITY OF ESSENTIAL COMMODITIES. AS THE PUBLICATION DATE FOR THE BUDGET DRAWS CLOSER, THE SCARCITIES WILL BECOME WORSE SINCE

TRADERS TRADITIONALLY HOLD BACK GOODS IN EXPECTATION OF TAX
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INCREASES WHICH CAN BE CAPITALIZED IN THE PRICES OF EXISTING
STOCK.

8. COMMENT: ZIA OBVIOUSLY WENT INTO THAT BASTION OF KARACHI
CAPITALISM (THE STOCK EXCHANGE) PREPARED TO TELL THE FINANCIAL
COMMUNITY WHAT IT WANTED TO HEAR. ZIA'S POLICY PRONOUNCEMENTS AND
THE OVERALL TONE OF HIS SPEECH INDICATE THAT, ALTHOUGH HE HAD
SOME MISGIVINGS ABOUT CERTAIN ANTI-SOCIAL BEHAVIOR OF SOME IN THE
PRIVATE SECTOR, HE IS STILL DISPOSED TO ESTABLISH RULES THAT
BUSINESS WOULD LIKE. HIS OVERALL THRUST PLACES HIS
ADMINISTRATION SQUARELY IN THE FIRST OF THE TWO ECONOMIC PERIODS,
HE DESCRIBED I.E., PRE-BHUTTO. DURING THE "GOLDEN AGE OF THE
SIXTIES," A REFERENCE WE HAVE HEARD OFTEN FROM GOP OFFICIALS, THE
INCENTIVES UNDOUBTEDLY CONTRIBUTED TO RAPID, IF SOMEWHAT
UNBALANCED, GROWTH; BUT THEY WERE NOT CONDUCIVE TO AN EQUITABLE
DISTRIBUTION OF INCOME. THIS GOVERNMENT IS ALSO COMMITTED TO A
BASIC HUMAN NEEDS DEVELOPMENT STRATEGY AND TO REDUCING THE INCOME
GAP BETWEEN RICH AND POOR, EVEN THOUGH ZIA NOW SAYS THAT PAST
ATTEMPTS TO HAVE A MORE EQUAL DISTRIBUTION OF WEALTH FAILDF AND
LEFT THE COUNTRFBZORSE OFF. ZIA DID NOT MAKE CLEAR HOW HE PLANS
TO OFFER 1960S TYPES OF INCENTIVES UNDER A GROWTH WITH EQUITY
PHILOSOPHY; SUCH GAPS BETWEEN BROAD POLICY PRONOUNCEMENTS AND
BASIC IMPLEMENTING STRATEGY ARE, OF COURSE, NOT UNCOMMON.

9. ZIA'S CONCERTED POLICY STATEMENTS ON TAXES AND
DENATIONALIZATION WILL BE WELCOMED BY THE PRIVATE SECTOR, HOWEVER
MUCH OF THAT SECTOR IS BY NOW CYNICAL AND SKEPTICAL OF HOW MUCH
ZIA CAN AND WILL DELIVER AND HOW LONG WUCH MEASURES WILL LAST.

10. ONE CAN FAIRLY SAY THAT ZIA'S SPEECH WAS TAILORED TO THE
AUDIENCE. HOWEVER, THE MEASURES HE HAS OUTLINED WILL APPEAR TO
HIS BROADER AUDIENCE AS FURTHER INDICATION THAT HIS REGIME IS
ALIGNED WITH THOSE IN THIS SOCIETY WHO ARE AMONG ITS MOST
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PRIVILEGED -- BIG LANDOWNERS, BIG BUSINESSMEN, BIG
INDUSTRIALISTS, ETC. -- RATHER THAN WITH THE POPULAR ASPIRATIONS
OF THE VAST MAJORITY OF ITS CITIZENS WHO AT BEST ARE DESPERATELY
POOR. WHILE HIS POLICIES, AS OUTLINED, MAY HOLD THE PROSPECT FOR
MORE RAPID DEVELOPMENT THAN THE BHUTTO-ERA DISTRIBUTIVE AND
POPULIST APPROACH, HIS PERSONAL COMMITMENT TO THEM AND THE WAY HE
FORMULATED THEM AT THE STOCK EXCHANGE WILL DO LITTLE TO ASSURE
THAT LARGER NUMBER OF PAKISTANIS WHOSE DESTINY IS IN HIS HANDS

THAT HE HAS THEIR INTERESTS AT HEART. AS HE APPROACHES HIS FIRST
YEAR ANNIVERSARY IN POWER, HIS POLITICAL SUPPORT IS LAGGING, AND
HE HAS HAD TO ADMIT THE FAILURE OF HIS EFFORTS TO ORGANIZE A
"NATIONAL GOVERNMENT" (SEPTTEL). THE POLICIES OUTLINED IN THIS
SPEECH WILL DO LITTLE TO COUNTER HIS GRADUAL LOSS OF PUBLIC
SUPPORT OR THE SUSPICION THAT UNDER THIS REGIME, IT IS THE HAVES
WHO WILL GET. HOW SERIOUS HE IS WILL BECOME APPARENT WHEN THE
BUDGET AND THE NEW FIVE YEAR PLAN COME OUT LATER THIS WEEK.
HUMMEL

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